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THE INTERNATIONAL DEBT CRISIS: A DISCUSSION PAPER PREPARED FOR THE CANADIAN CHURCHES

JULY 1989

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in cooperation with representatives of GATT-Fly
and the Inter-Church, Inter-Coalition Debt Network

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FOREWORD

Those who have read the "Working Paper on the International Debt Crisis for the Canadian Churches" (September 1988) will recognize large sections of the first two parts of this present paper.

The third section containing the recommendations to the Canadian government and banks has, however, been extensively revised as a result of discussion in the churches and in the ecumenical "debt study network". Changes have also been made as a result of comments from those in the universities and the banks with whom we have shared it, and as a result of very helpful contributions from the staff of GATT-Fly and Ten Days for World Development. These last were drawn from the encounters local Ten Days groups across the country had with the banks over this issue in 1988-89.

A number of events in the past year, most notably the Brady Plan and the Mexican rescheduling agreement, have necessitated the addition of new material to Part I. The Venezuelan riots in February, sparked by the introduction of an IMF-inspired government austerity program, are not mentioned in the text but were an illustration of several of its points.

It is not the Taskforce's intention to continue to update this particular paper. The individual coalitions and churches will continue specific pieces of work responding to and growing out of its recommendations; these will naturally evolve as the changing situation warrants.

In the course of the past year, most of the major churches have moved to adopt official policy positions on this issue. Some of these positions are in quite specific terms, bearing close resemblances to the recommendations in this paper; some give more general "approval in principle" to the broad bases of this paper.

The endnotes, which are quite extensive, give further illustrations and explanations of some points, and also suggest sources for further reading. A more complete resource list is available.

The original paper aroused considerable interest although it intentionally had rather limited circulation. It is the churches' hope that this new version may serve to stimulate both awareness and

discussion in a wider segment of the Canadian public. It is an issue of vital importance to many millions in the developing world.

Taskforce on the Churches and Corporate Responsibility,

July 31, 1989.

DISCUSSION PAPER FOR THE CANADIAN CHURCHES ON THE INTERNATIONAL DEBT CRISIS JULY 1989

INTRODUCTION

The government keeps telling us that we must work harder, to produce more, and, at the same time, consume less, in order to have more to export, and with these exports to pay - not the debt! - only the interest on the debt...This year alone...we must export 650,000 tons of meat! Not to mention soybeans, corn and other food exports. We in the Third World are exporting food while we are dying of hunger.

(Fr. Jose Alamiro, a Franciscan priest in Brazil)

We will not tolerate economic formula, will not apply economic indices... which fail to assert the primacy of the human condition...Nutrition imbalances are as crucial as trade imbalances. High infant mortality requires just as immediate and as serious attention as high rates of inflation or huge budget deficits... Therefore, a basic test for all stabilization, adjustment and development programs is whether they will improve the human condition from their inception, or, on the contrary, worsen it.

(from the Khartoum Declaration, a statement of a conference of African governments held in Khartoum, Sudan, March 1988, under the auspices of the United Nations Economic Commission for Africa.)

The poor in our world have become poorer. In the past ten years, despite massive development assistance, the gulf which divides the world's people into rich and poor, into powerful and powerless, has grown wider.

There are several reasons for this deterioration, but one stands out from the others, both because of its significance and its complexity. Many developing countries are deeply in debt to the governments and banks of Europe, North America and Japan. Despite their efforts to meet interest payments, many countries are in such economic distress that they can only make partial payments, or none at

all. Unpaid interest is added to the principal, and the mountain of debt continues to grow.

Banks and governments in the creditor nations now realize that the loans made to many of these countries can never be repaid under current conditions. Yet they cannot agree on an alternative way of resolving the crisis.

Meanwhile, debtor nations continue to be pressed to pay as much as they can. Conditions imposed by the international financial institutions force them to impose stringent "austerity measures" on their people, many of whom are already among the poorest on earth.

Our church partners in these debtor countries are keenly aware of this crisis and the hardships it has caused. People's organizations and the governments of these countries have wrestled with the problem and have put forward their own proposals, which merit careful consideration by the creditors.

As the people of the world call on the international community to redress the injustices caused by the debt crisis, so we as Christians and Canadians call on our government and banks to accept their social responsibility to work towards a resolution of the problems.

The solutions which must be found will require complex political and economic negotiations, but the determination needed to carry them through must grow from a passion for justice and fair dealing. As Christians, we must raise our voice in unison with the victims of this crisis; we are calling for justice, not charity.

PART ONE

THE INTERNATIONAL DEBT CRISIS: AN OVERVIEW

Most descriptions of the debt crisis identify four groups of "actors": governments of the industrialized countries; governments of the developing countries; private banks; and the international financial institutions (the International Monetary Fund, the World Bank, and regional development banks). A brief overview of the debt crisis will clarify the roles played by each of these actors.

Often overlooked in a description of the crisis are the people of the developing countries, on whom the major burden of this crisis is falling. This overview contains their perspective, as it has been relayed to us by our church partners and Third World leaders.

I. THE CRISIS

Between 1975 and 1981, the volume of lending by the banks of the industrialized world to developing countries reached unprecedented levels. One reason was the active promotion of loans by banks which had a surplus of money on deposit. Some of this surplus came from deposits by the newly rich oil-producing countries as a result of the dramatic rise in oil prices. More important, however, was the unregulated working of international currency markets following the dismantling of the Bretton Woods system in 1971.[1]

Most of the bank loans went to countries of Latin America and Asia; some went to the Caribbean, and a small number to Africa. In many cases, the governments who borrowed these funds were dictatorships. Although some of the loans were put to good use, many were squandered on wasteful ventures, or for the purchase of military equipment and arms.

At the same time, governments of the developed world and the international financial institutions loaned newly independent countries in Africa and Asia funds for projects intended to aid development.

Our church partners comment on how many of the loans were used:[2]

Development projects undertaken by a dictatorship who took its priorities from the rich upper class resulted in huge ostentatious building projects of no real value to the nation. They can only be compared with similar state building projects in ancient Egypt; we call them "Pharaonic". These projects are false development, built at huge cost to the public.

(Catholic Bishops' Conference of Brazil, 1984)

There has been a squandering and misappropriation of public funds, borrowed from foreign banks...

(Catholic Bishops' Conference of Panama, 1984)

In Venezuela, no one knows the exact destination of these loans, or where the development projects - the hydro-electric dams, the universities, the roads - are. Indeed, on the contrary, there are unfinished, abandoned and ruined projects everywhere.

(Mensaje Iberoamericano, 1987)

Enormous sums of money, originally intended to meet the urgent needs of the people, were diverted to buy weapons.

(Secretariado Episcopal de America Central, 1985)

Compounding the problem further, the elite of many debtor countries - in some cases dictators who have since been deposed - took for themselves large parts of the monies their governments borrowed, and sent it abroad to deposit accounts, often in the very banks from which the loans were made.

The total debt of the Philippines equalled US $28.5 billion in 1987. One American bank, Morgan Guaranty Trust, estimates that US $12 billion of this amount has been "salted away" outside the country.

(Business Week, 21 April, 1986)

In our region, we know industrialists and important business people who were helped by their governments to obtain cheap loans, which were then diverted to private purposes.

(Pastoral Message of the Catholic Bishops of the South Pacific, 1984)

We protest the bribery and profiteering rampant in society, and the damage done by the wealthy elites who have transferred huge sums out of their countries to private bank accounts in Europe and North America.
(Catholic Bishops' Conference of Mexico, 1987)

Capital sent out of the country almost equals the foreign debt, which is now being paid for in hardships suffered largely by the poor.
(Catholic Bishops' Conference of Venezuela, 1986)

In 1981, the industrialized countries, led by the United States, introduced sharply higher interest rates in order to control domestic inflation. Interest rates more than doubled within a short period. The size of the original Third World debt grew rapidly as unpaid interest was added to capital. Since then, interest rates have dropped, but they are still significantly higher in real terms than they were at the time the loans were made.[3]

From 1979 to 1986, Brazil has paid back the equivalent of the total amount of its external debt (over $100 billion) as payment for debt servicing (interest) while hardly touching the principal.
(Catholic Bishops' Conference of Brazil, 1986)[4]

To add to the debtors' problems, the prices of many raw materials (commodities) which they export to gain foreign exchange have fallen during the 1980s, and many markets in the industrialized countries are closed to them by high tariffs.

In some countries, the pressure for increased earnings from export crops has diverted land away from its customary use of growing food for the local people. This was condemned by the World Council of Churches Sixth Assembly in Vancouver 1983 which called on its member churches to denounce:

policies that the International Monetary Fund (IMF) imposes on nations in debt which result in the reduction of food available to the poor, thereby increasing malnutrition, hunger-related diseases and infant mortality.[5]

Moreover, the overriding demand to increase export earnings leads debtor nations to extract the maximum immediate profit from their natural resources, with consequent severe damage to the envi-

ronment. In addition, debtor nations must exploit their one "advantage" in the international economy, cheap labour, undercutting each other and First World labour.

Despite these efforts, many countries have fallen so far behind in their payments that their loans have had to be renegotiated several times, with more money being loaned to them in order to enable them to meet interest payments. As many Third World churches have noted, this situation is absurd, and yet a vicious circle of growing non-payable debts has been established.

It is important to note that some countries in the developing world have avoided the "debt trap". Some of these (South Korea, and Taiwan for example) succeed in servicing large foreign debts because of strong export-oriented economic programs. The banks point to these countries as examples of what can be done with the "right economic policies"; the churches acknowledge the economic accomplishments of these countries but point to the other side of the record: both countries suffer repressive governments and the abuse of human rights. India, however, has managed its economy according to more self-reliant principles, and so has avoided acquiring a foreign debt burden.

When it became clear that many countries were unable to cover even the interest payments on their debts, either to commercial banks or to government lending agencies, the international financial institutions, led by the International Monetary Fund (IMF), became, in effect, economic police.[6]

In return for renegotiating the outstanding debt, the IMF demanded drastic "restructuring" of the debtor countries' economies. This restructuring was designed to increase exports, "open" the country to market forces and cut back on government spending, with the goal of improving the balance of payments and assisting the countries to "grow their way out of debt".

These policies have been in force for several years, but with very few exceptions, it is clear that the countries are not able to cut back enough, or export enough, to produce sufficient surplus to reduce their debts.

It is also painfully clear that the enforced cutbacks in government spending have cut social services such as health care and education. The removal of subsidies on basic foodstuffs and necessi-

ties such as cooking fuel and bus service has increased living costs for the poor in many countries.

Our partners have observed the damage which has resulted from these policies.

> *The IMF austerity measures adopted in Bolivia caused the price of the daily bread of the poor to double over night, and the price of kerosene, used for light and cooking, to treble.*
>
> *(United States Catholic Conference, 1986)*

> *The world financial system is a greater cause of hunger in Africa than drought.*
>
> *(Sam Kobia, Kenya Council of Churches, 1986)*

Cutbacks in government programmes and low prices for exports have created unemployment and generally depressed economies. The living standards of the poor have declined sharply in all the countries with debt problems; the countries of sub-Saharan Africa have suffered a 25% decline in average income since 1980. UNICEF statistics show that malnutrition among children has been rising in many countries over the past few years.[7]

When the people protest against cutbacks, they are frequently met with repression; dictatorships can more easily enforce the conditions attached to debt negotiations, while fragile democracies are imperilled.

> *It is no secret that riots and loss of life have spread through the Third World as a consequence of the policies of the IMF. These policies have led in the past, and may lead again, to military dictatorships. An elected president can only go so far in cutting off his peoples' means of survival. A military government, with its armed forces, can ensure that an austerity program is followed. None of the military presidents (of Brazil) asked for advice or permission of the National Congress in incurring these debts. The foreign debt is a dictatorial decision imposed on a whole nation. How, where and why the money was spent is never explained.*
>
> *(Cardinal Arns, Brazil, 1986)*

The fact that both the IMF and the World Bank set conditions for a country's economic performance complicates the problem

further. Generally, these two policies are complementary, but as they are applied in detail, they may be contradictory. In either case, a small country is tied hand and foot, and has no bargaining power left to resist the edicts of the international authorities.[8]

Even a country like Nigeria, the largest sub-Saharan African country, feels it has regressed three decades into colonial status. Nigeria has become

> *a financial protectorate of the IMF...we take our economic programs to them for approval; and they tell us what kind of social and economic restructuring we must pursue. It is just as if we were back in the old colonial days, when the Colonial Office had to approve our budgets and programs, subject, of course, to these being serviceable to the larger aims of our masters.*
>
> *(excerpt from an editorial in The Guardian of Lagos, Nigeria, 1985)*

II. RESPONSES FROM CHRISTIANS IN THE DEBTOR COUNTRIES

Many Christians in the debtor countries have given the ethical implications of the debt burden careful and responsible study. This has led them to challenge the legitimacy of some of the debts incurred by their countries, and to maintain that there is no ethical responsibility to repay them.

> ***Just as it is morally imperative to repay all legitimate debts, it is also ethically legitimate and a proper exercise of national sovereignty for the nations affected to...refuse to pay, in whole or in part, any illegitimate debts, or debts on which such extortionate rates of interest are charged as to endanger the lives of their citizens and the stability of democratic governments.***
>
> ***(College of Methodist Bishops, Brazil, 1985)***

> ***The huge efforts of the past two years have resulted in an export surplus of one billion dollars per month - one billion dollars which Brazil immediately remitted to the banks. Yet this money served only to pay the interest on***

the debt. It is impossible to go on this way. We have already taken everything the people had to eat, even though two-thirds of them are already going hungry. When we borrowed, interest rates were 4%; they are 8% now, and at one point were as high as 21%... The people are expected to pay off the debt in low salaries and hunger, but we have already reimbursed the debt...twice over, considering the interest paid. We must stop giving the blood and misery of our people to repay the First World.

(Cardinal Arns, Brazil, 1986)

If you can pay debt, pay: it is honourable to pay debt. If you cannot afford, it is a sin to pay. It is immoral to repay loans and leave children starving.

(Julius Nyerere, Tanzania, as quoted in the Nairobi, Kenya, Sunday Nation, May 1988)

Christians in countries most affected by the debt crisis see clearly the basic injustice of the situation. The poor in debtor countries are paying more for the necessities of life in order that huge sums in interest can be sent to First World banks and governments. Moreover, the poor are paying for irresponsible decisions made by their governments in which they have no real voice, decisions often made to satisfy the priorities of a small wealthy upper class.

The poor nations cannot pay intolerable social costs by giving up their right to the little they have while other nations enjoy opulence.

(Pope John Paul II, 1986)

No reading of Scripture would oblige hungry people to starve themselves and their children simply to honour contractual obligations to repay rich people and institutions.

(Archbishop Carter, Jamaica, 1987)

The rich and powerful acted irresponsibly to contract debts, the consequences of which now weigh upon the people in the payment of international debts, and the reduction of public services.

(Conference of Catholic Bishops of Panama, 1984)

Those who must make decisions about accepting loans must not forget that this country already has a very large debt...and repayment will affect all the people.

(From a sermon preached by Bishop Segun of the Baptist Church of Lagos, Nigeria, when President Babandiga was present, 1987)

We're always asking ourselves, we housewives: What did we do that we have to pay this foreign debt? Is it that our children have eaten too much?...Or gone to the best schools?...worn the best clothes...Or have our salaries been too high?...Have we better houses?...We all shout in unison: No! So who has benefitted? Why are we the ones who have to pay that debt?

(Dominga Valasquez, member of the "Federation of Shantytown Housewives", La Paz, Bolivia, 1986)

The present policy for solving the debt crisis is immoral, and cannot be reconciled with a Christian conscience. We call upon brothers and sisters in faith in those countries which are influential in the world economy to use their moral strength to demand speedy solutions...

(Bishop Terrazas of Bolivia and seven bishops of the Andes Region, 1987)

III. THE FUTILITY OF PRESENT COURSES OF ACTION

It is acknowledged by creditors and debtors alike that, no matter what sacrifices they make, most of the debtor countries in sub-Saharan Africa simply cannot repay their debts on normal commercial terms. These debts, largely to international financial institutions and to governments in the developed world, must be paid on "concessionary terms" if they are to be paid at all.

The Latin American debtor countries, whose loans came mainly from commercial banks, have the potential to pay at least some of their debts. But at present levels they can service their debts only at enormous sacrifice, a sacrifice which weighs most heavily on the most vulnerable sectors of their societies.

It is also generally recognized that all these financially troubled countries require an increased inflow of resources in the form of aid from governments, and new loans from banks in order to get

their economies moving once more. Yet neither aid nor new investment has been forthcoming to the degree required.

Meanwhile, wealth, in the form of interest payments, is flowing out of Latin America and Africa to the banks and governments of North America, Europe and Japan. Since 1985, the flow of interest payments to the developed countries has significantly exceeded the flow of new loans and aid money to the debtor countries.[9] The debt for many countries has grown to staggering proportions: Brazil - $112 billion; Mexico - $104 billion; Chile - $20 billion; Bolivia - $4.2 billion.

Various strategies are being tried by the banks to come to grips with what is for them an extremely intractable problem. Realizing that they will not be able to get a full return on their loans, banks are trying to work out the best arrangements possible.

Thus, portions of debt owed by various countries are offered for sale to investors at heavily marked down prices (Brazil's debt at 31% of face value; Mexico's at 40%, Chile's at 63%; Argentina's at 14%; Peru's debt was offered at 6% in May of 1989; there were no bids for it in June).[10] It is important to realize that there is no tangible benefit to the country from the discount offered on its debt. It could be considered an implicit recognition by the international financial community that the debt is unlikely ever to be paid.

A variation of this "secondary market" in Third World debt is the mechanism called the "debt-equity swap". In some cases, there may be some benefits. However, there are disadvantages from having that debt "swapped for equity". This is explored in more detail in Part III.[11]

In addition, there have been several recent initiatives involving governments which point the way to more far-reaching solutions. Limited though they are, they are an indication that at last the creditor governments are coming to realize the seriousness of the situation.

In Toronto, in June of 1988, the Group of Seven Economic Summit addressed the problem of debts owed by sub-Saharan African countries. Prior to this meeting there had been a willingness on the part of some creditor countries to make concessions to the hardest pressed African countries; other creditors were either not

able or not willing to make concessions. In any case, there was no consensus as to the type of concession to offer, and the rules governing Club of Paris discussions where such debts between countries are negotiated had insisted that all countries must offer the same terms.

A breakthrough was achieved at the Toronto meeting, due in part to Canada's leadership. (For more details of Canada's role in the debt crisis, see endnotes.)[12] It was agreed that the insistence on uniform terms would be waived in the case of the most seriously affected African countries. A "menu" of three options, each of which offered easier terms was agreed upon, and creditors were permitted to choose one of these options - or none of them.

However, in order to qualify for these longer repayment periods and reduced interest rates, countries must continue to accept IMF conditions with all that they imply.

Canada and a number of other countries opted to reduce their interest rates by 3%. Unfortunately, within a few months of the Summit meeting, interest rates had risen by an equal amount and so this concession was wiped out. Without the concession, however, African countries would be even worse off than they are now. Nevertheless, it is very evident a year later that this concession, although a step in the right direction, is painfully inadequate.

While the Toronto Summit concerned itself with the least developed countries of Africa, an initiative from the United States in the spring of 1989 was directed at the middle income countries of Latin America and the commercial banks. Nicholas Brady, Secretary of the Treasury, put forward a new "Plan" for addressing the debt owed to the banks; its best feature is an official acknowledgement that a measure of debt reduction is inevitable. Recognizing the banks' skepticism, the U.S. government has worked hard to persuade them.

This "Brady Plan" has won the support of Canada and other Group of Seven countries, although there is less enthusiasm in Europe than in the United States. The first test case was the rescheduling of Mexico's debt, which entailed prolonged negotiations between the Mexican government and a committee representing the approximately 500 banks which have loaned it money. In late July (just as this paper was being completed) an announcement was made

that a debt reduction agreement had been reached between Mexico and its creditor banks.

Close examination, however, shows that this agreement may not be as significant as it seems. Mexican economists and many other observers had stated prior to the negotiations that only a reduction of 50% could have any real impact on Mexico's economic problems. Many of the details have not yet been settled and it is suggested that the final result will be considerably less than 35%. 20% of Mexico's debt was not up for rescheduling, and so is not affected by this agreement. In addition, it is not yet clear how many of the banks involved will accept as large a reduction as was agreed.

The principal criticism from several sources is that the banks are given guarantees on their loans by special financing provided by the IMF, the World Bank, Japan and Mexico as an incentive to take a reduction (either by forgiving 35% of the loan or by cutting the interest rate to 6.25%). IMF and World Bank funds come from the taxpayers of the creditor countries, and the governments of those countries have been reluctant to augment those funds for this purpose because they believe their citizens will see this as a way of using public funds to cushion the banks from the results of bad decisions.

The Mexican agreement should not be seen as a breakthrough for other countries. Mexico's strategic importance to the United States and the lengths to which it has gone to re-structure its economy according to IMF principles made it the leading contender for most concessionary treatment. Other large debtors like Brazil and Argentina have not performed as well by IMF standards and have several times defaulted on their debt servicing. The chances are very remote that they would be given even the same limited concessions as Mexico.

Although it is too early to tell how the Mexican agreement will finally work out, or what its implications are for other countries' debt negotiations, it seems that although it contains grounds for hope, both this agreement and the Brady Plan as a whole fall far short of an overall solution to the crisis.

In conclusion, the world's governments and the banks have recently taken a few small steps to addressing the debt issue, but we are still a long way from grappling with the ongoing crisis in the developing world. Resources are still being drained from the devel-

oping to the developed world. Deterioration in living standards of the poor of debtor countries is still being documented by the United Nations, by the churches, by peoples' organizations.

In the meantime, the preparation of this paper and many others like it together with the growing number of conferences on the debt issue are all hopeful indications that public awareness in the creditor countries is growing. Gradually, but tragically slowly, we are recognizing this crisis for what it is - a major contributing cause of the desperate economic hardship suffered by the peoples of the developing world, and clear evidence that the world's economic system needs reforming.

PART TWO
THE RESPONSE OF THE CANADIAN CHURCHES

All the parties in the debt crisis, governments, banks, the international financial institutions, the people on whom such terrible burdens have been imposed, and we ourselves have a part to play in the resolution of this crisis.

We in Canada must do our part. We have experienced little of the pain, but we can express our solidarity with those who are suffering. We can support those among both debtors and creditors who are seeking solutions which would be at once realistic and just, which would give hope to the developing world and new direction to the world financial system.

Together with our colleagues in the Third World, we believe that it is imperative for the churches to point out the moral and ethical implications of economic practices.

I. THE CHURCHES' PERSPECTIVE

As Christian churches in Canada, we are appalled that twenty-five years after the "end" of colonialism, the developed countries continue to drain riches from less developed African, Latin American and Asian countries.

Our common faith teaches that it is contrary to the will of God for the rich to profit at the expense of the poor. It also teaches that it is contrary to God's will that power and wealth should accrue increasingly to a few, leaving the poor majority powerless to improve their situation.

We see how the divisive and destructive implications of international debt servicing are reflected at a national level between many debtor governments and their people.

Just as the international institutions, acting on behalf of creditor governments and banks in the First World, demand maximum servicing of debts, so debtor governments, under heavy pressure from these same institutions, demand the utmost sacrifices from their already impoverished people.

We protest the deepening deprivation now being imposed on

the poor of the developing nations whose governments are in debt to the industrialized world.

Many feel helpless in the face of economic forces which appear to operate according to their own internal dynamic. We must recognize that exploitative economic systems, like any human institution, are one of the "principalities and powers" against which St. Paul warns us.

We confess our failure as churches to respond to our partners' call, and we acknowledge our unwillingness to come to terms with economic issues. We confess our failures as individuals, and as a country; we realize that our greed, our irresponsibility, and our abuse of power helped to create the very crisis we are now protesting.

God calls the Church to take the part of the poor and the weak, and to be advocates with and for them in our own country, with our government and our financial institutions.

We have a vision of a world transformed by Gospel values, a world of justice, compassion and peace, where the environment is protected, where the rights of all are respected, and the basic needs of all are met - a world where profit and power are not the universal motivating forces.

We believe, therefore, that the answer lies in striving to incorporate Gospel values in economic relations between individuals, and between nations.

II. THE CHURCHES' CRITERIA

Over the course of the discussions which led to the framing of the recommendations in Part III, the churches agreed that the following criteria serve to incorporate Gospel values and give a human dimension to economic issues. In considering the alternative solutions which are put forward to the problems caused by the debt crisis, the churches asked:

1. *Will the proposal help or hinder the provision of the basic needs of the majority?*
2. *Will the proposal enhance the ability of people to provide their basic needs through a narrowing of the*

gulf in power and possessions between rich and poor, or will it reinforce social inequalities?

3. *Will the proposal enhance the ability of governments to pursue independent self-reliant development?*

4. *Will the proposal strengthen political structures through which the will of the majority can be ex - pressed, and through which the people can participate in shaping decisions which will affect their lives, giving them a sense of their own worth and capacity?*

5. *Is the proposal environmentally and ecologically sustainable over generations?*

6. *Does the proposal consider the needs of the global community, beyond national or regional political boundaries?*

7. *Does the proposal promote the prospects for peace built upon the foundation of justice?*[13]

The following recommendations are based on these criteria.

PART THREE

RECOMMENDATIONS TO THE CANADIAN GOVERNMENT AND BANKS

I. RECOMMENDATIONS ADDRESSED TO GOVERNMENT

1. The present crisis: addressing the problems caused by structural adjustment programs.

Since long before the debt crisis was widely recognized, a country experiencing problems servicing its external debt has had to apply to the International Monetary Fund (IMF). This body, usually working with the World Bank, carries out an analysis of the country's situation; if the country enters into an agreement with the IMF, it agrees to institute changes in its economic policies which are termed "structural adjustments" as well as introducing austerity measures. These changes must be carried out if the country's debt is to be rescheduled, and it is to be declared eligible for any new resources, from either the multilateral bodies (IMF, the World Bank, and the regional development banks) or from the individual countries which make up these organizations and have their own bilateral aid programmes.

These changes, although "voluntarily" adopted by the country, reflect the analysis which was carried out by the international financial institutions, and their prescriptions for changes to the economy.

The record of past years has shown that very often debtor countries find these conditions impossible to fulfill within the short time line laid down in the agreement they have made with the IMF. Those who do manage to fulfill the requirements have found them destructive to the well-being of the majority of their people, at least in the short term. In addition, in the case of a number of countries, development goals which had been established previously for the country have had to be abandoned or severely modified.

The economic philosophy underlying IMF policies, (on which its recommendations for structural adjustments are made) is very clearly articulated. This is the belief that an open economy, one which participates without reservation in the international trading system, is the economic model best suited to all countries. In order to move a country towards this open economy, the following measures are usually called for:

- reduction in government expenditure and the size of the public sector
- rationalization, and often privatization, of public enterprises
- removal of subsidies and price controls
- higher interest rates to encourage investment
- removal of trade and exchange controls in order to promote an export-oriented trade policy
- higher prices for agricultural producers, especially producers of export crops.

As can be seen, these policies reflect the prevailing business and political philosophies of many Western countries.

The churches, however, have serious reservations about the benefits of "opening up" the economy of a small country so that its resources can be developed on a large scale by international companies, if the main purpose of such development is to generate exports to earn the exchange needed to service external debts.

On the one hand, we recognize the importance of bringing the debtors' balance of payments problems under control, and so we acknowledge the importance of increasing export earnings to provide exchange for some level of debt servicing. Increased export earnings are also necessary in order to purchase the essential imports for its development. Offsetting these requirements, however, the churches would place equal, if not greater, emphasis on the obligation of the debtor government to provide its citizens with their essential requirements - food, shelter and a minimal level of health care, education and basic infrastructure. If the two obligations are in conflict, the churches would place a higher priority on the debtor government's responsibility to its people than on its obligation to service its debt in full.

The churches also have concerns about the IMF model of development because it increases developing countries' dependence on overseas markets, and their vulnerability to manipulation by powerful transnational corporations. Complete isolation for a country is neither possible nor desirable. On the other hand, forcing small weak economies to participate in the international trading community as it is presently structured makes them vulnerable to domination by external economic powers. Some of those who had

tried to protect themselves from such domination by planning more self-reliant economic strategies are now no longer able to do so. In that they are no longer able to shape their own economic priorities, they have already lost their sovereignty.

In the view of our partners in the debtor countries, who have experienced IMF-backed conditions at first hand, they are excessively harsh and inflexible. We strongly regret the fact that the Canadian government, like other creditor governments, links its debt relief to African countries to their acceptance of these conditions.

The churches acknowledge that any solution to the debt crisis requires that the problems of economic mismanagement in the debtor countries be addressed. However, we believe that in most cases there are other problems which must be tackled if these countries are to be able to provide a better life for all their people. In addition to changes in economic policies which would encourage local initiative and eliminate waste and corruption, the churches would welcome conditions on new loans relating to the protection of human rights, the provision of basic needs, and the ability of a country's leadership to establish a free, just, and sustainable society.

The churches recommend that the Canadian government, as a member of the International Monetary Fund, urge that the policy conditions which the Fund attaches to the credits which it extends to debtor countries, (which are also widely treated as prerequisites for assistance from other donors) be changed. New conditions should ensure that basic human rights are respected, that the already poor in these countries are not further deprived, and that their governments are not so constrained as to be unable to promote further development along lines which they deem appropriate; further, the churches recommend that the Canadian government also promote adherence to these policy prescriptions at the World Bank and the international regional development banks, of which Canada is a member.

(Recommendation # 1)

Various measures have been suggested which would "cushion the impact" of IMF-backed austerity measures on the most vulnerable sectors of society. As we have stated, our preference would be for the adoption of entirely new forms of conditionality. Nevertheless, for humanitarian reasons we must support the call for remedial measures, and urge that the IMF, as a minimum response to the present situation, give immediate attention to the social effect of its present conditions.

The United Nations' children's fund - UNICEF - has prepared a report on the impact of the adjustment policies which many developing countries have had to adopt during the 1980's at the insistence of the IMF, the World Bank, and the regional development banks. As note 7 indicates, these statistics show the impact of these policies on the most vulnerable segment of society - its children.

UNICEF makes a number of specific recommendations for short- term modifications to the process of structural adjustment which we would support.[14]

In particular, we commend the recommendation that when the IMF instructs a government to reduce its overall spending, those parts of public spending which directly affect the health and well-being of the poor, and particularly the children of the poor, be exempted. We also welcome their suggestion that debtor countries should involve government officials responsible for health, education and agriculture in debt negotiations.

> ***The churches commend the recommendations found in the UNICEF study, and urge the Canadian government to use its influence to have them widely applied to all IMF debt negotiations.***
>
> ***(Recommendation #2)***

2. Moving to a resolution of the debt crisis.

The essential first step towards resolving the debt crisis is for all parties to agree that it must be resolved. The agreement reached by the Group of Seven Economic Summit in June 1988 to facilitate debt relief to the sub-Saharan African countries, limited though it was, shows that progress is possible if governments find the requi-

site will. Further progress is being made, albeit slowly, through the proposal put forward by U.S. Treasury Secretary Nicholas Brady.

Nevertheless, we are gravely disturbed at the slowness with which the whole debt problem has been addressed, and echo the many appeals from our partners that the nations of the world, together with the financial institutions, make the resolution of this question a matter of the highest priority.

We realize that all parties to the debt crisis operate under constraints which are often defined by law. Nevertheless, these laws are themselves the product of political negotiations, and can be altered, given the willingness to do so. For, unless new solutions are found, the burden will continue to fall on the debtor countries, pressing most heavily on the classes within those countries least responsible for incurring the debt, and least capable of further sacrifice to pay it. Therefore:

> ***The churches urge the Canadian government to take a stronger lead, in cooperation with other concerned countries, both creditors and debtors, and the commercial lenders, in finding ways of resolving the debt crisis.***
>
> ***(Recommendation #3)***

Canada's traditional role in international affairs is to work with others through multilateral channels, a method which is particularly appropriate in the present crisis. The following recommendations point to several initiatives we urge the government to undertake.

a) A new framework for international trade

The debt crisis is only one of many symptoms of disorder in the international financial system. The agreements signed at Bretton Woods four decades ago no longer adequately guide international commerce and finance.

> ***The churches urge the government of Canada to advocate and actively promote the calling of a new round of multilateral negotiations on the creation of a new framework for international trade and finance which would provide greater stability and a more equitable basis for economic relationships. Such a framework***

should respect the rights and advance the development efforts of Third World countries, enhance their ability to pursue self- reliant development, make provision for an increased flow of development assistance (as well as for adequate bridging assistance for countries facing serious foreign exchange crises) and promote more responsible stewardship of the earth's resources and environment.

(Recommendation #4)

b) An international conference on North-South issues

In the past few years, strong requests have come from debtor countries, notably those in Africa and Latin America, for a global conference which would include both creditors and debtors. This call was supported by many Canadian individuals and groups who submitted briefs to the Special Joint Parliamentary Committee on Canada's International Relations, and appears as one of that Committee's recommendations to government.[15]

More recently, in July 1989, the leaders of Third World countries who were present at the Group of Seven Summit in Paris issued a pressing call for a "North-South" conference which would address the debt crisis and other outstanding economic issues between the developed and developing countries. This could be seen as an initial step in the more comprehensive negotiations which could lead to a "new Bretton Woods".

The churches request the Canadian government to consider sympathetically the call of many of the debtor countries for an international conference on the debt crisis and other outstanding economic issues. This conference would be concerned with establishing criteria for the progressive reduction of insupportable debt, and with determining ways of moving towards more equitable terms of trade. It should be preceded by preparatory negotiations in which Canada and other middle powers from both North and South could play a creative role.

(Recommendation #5)

c) Expansion of the Group of Seven

In recent years, the Group of Seven, the self-appointed management committee of the international economic system, has managed the world's economic affairs through ongoing consultation and its annual "Economic Summit". Its membership, the United States, Britain, France, West Germany, Japan, Italy, and Canada represents exclusively the viewpoints of the developed world. If access to the Group of Seven is based on economic size, Brazil has arguably a better claim to membership than does Canada.

If such an ad hoc mechanism for managing the world's economy is to continue, the churches recommend that its size be expanded to include two major Third World governments, one of whom should be Brazil, and the Soviet Union. Such a grouping would be far more representative of the world's peoples, all of whom are affected by decisions taken in this forum. Therefore,

> ***The churches recommend that Canada propose that the Group of Seven be expanded to include Brazil, one other major developing country, and the Soviet Union.***
> ***(Recommendation #6)***

3. Addressing the debt crisis

While the churches have expressed strong concern over the worsening situation within many debtor countries where the weight of austerity cutbacks falls heavily on the most vulnerable sections of society, they are also gravely concerned by the scandal which has developed over the past few years as resources are drained from the developing countries to the wealthy countries of the industrialized world.

In the judgment of the churches, the goal should be to end the "debt crisis" by reducing each country's debt to the point where there is no longer a net outflow of capital, and the country has sufficient resources left after servicing its reduced debt to maintain its responsibilities to its people, and invest in its own development. Countries should not be required to divert their economies from development models designed to improve the quality of life for all their citizens to models dictated principally by the need to earn foreign exchange to service their debt.

Recent developments, particularly the introduction of the Brady Proposal with the backing of the U.S. government, indicate that there is some recognition of the seriousness of the situation. The recent rescheduling of Mexico's debt with an approximately 35% reduction shows that at last there is general acceptance of the principle that there must be some measure of debt reduction.

However, it has been widely predicted that Mexico's economic problems could not really be addressed without a reduction of at least 50%, and it remains to be seen if the 35% reduction, although an important breakthrough, will be adequate. Moreover, other countries which are not as strategic to American interests fear that they will not be given as preferential treatment.

> ***The churches support the principle of reducing the debt of the heavily indebted countries of Latin America, Africa, Asia and the Caribbean, through whatever mechanisms can be mutually agreed upon with the lending institutions; in addition, the churches support the principle of eliminating the debt owed by the poorest countries, specifically those in sub-Saharan Africa, to the governments of the industrialized countries. These initiatives should be combined with a requirement that governments give greater attention to the maintenance of basic human rights.***
>
> ***(Recommendation #7)***

a) Assessment of country situations

The "country by country" approach is valid in that each country's situation is different. However, we would maintain that the goal as stated above is the same in each case. The first step in each debt settlement negotiation would be to establish a mutually agreed-upon assessment of the country's situation. This would require the participation of all its major creditors and their governments, and a general willingness to accept a reduction in the size of the debts outstanding.

We can suggest several guides as indicators of the level to which a country's debt should be reduced.

One approach frequently suggested is to write the debt down

to the level it would have been if the historic level of real interest rates had been in place throughout the past decade. It is generally recognized that a major contributing factor to the growth in the Third World debt was the period (early 1980s) of interest rates nearing 20%. It is not generally known that the real interest rates being paid on Third World debt remained above 10% until 1986. Historically, real interest rates have averaged around 1.0% to 1.5%, a much more achievable level. (Real interest rates are not to be confused with nominal interest rates.)[16]

Recalculating interest payments to reflect the real rates prevailing prior to 1981 has been proposed by a number of analysts of the debt crisis. In effect, a negotiated settlement would retroactively write off excessive interest payments.

Another method of calculating the level of debt reduction required is to follow the criteria suggested in the second paragraph of this section. Given a realistic estimate of the level of export earnings, how much will the country require to ensure that its people's basic needs are met, while retaining a domestic surplus which can be invested in its own growth and development?

Our judgment is that these two goals will require very substantial reductions in debt servicing, as well as substantial new resources. As we have already seen, many Latin American countries estimate that only a debt reduction of 50% would make any real difference to their ability to achieve economic stability, let alone their chances of achieving the two goals we have suggested.

Assessment of the level of debt which a country can service should include the total amount of capital borrowed and repaid, the total amount of interest paid, the rates of interest, and the change in terms of trade over the period of indebtedness. Of vital importance would be an evaluation of the impact of present debt servicing on the poorest sectors of the population, as well as the impact on development and human rights.

It is vital that a country's "ability to service its debt" be judged not only in relation to its export earnings, or to the price of commodities, but also in the context of its need to promote a policy of autonomous, self-reliant development, bearing in mind specific "quality of life" indices, which would gauge the impact of the debt servicing.[17]

b) Settlement

The next step following a negotiated assessment of each country's situation would be a settlement of its external debt in the form of a broad agreement which would include partial debt reduction, rescheduling of the balance on manageable terms, and new resources, both aid and investment.Therefore,

> ***The churches strongly urge the Canadian government together with Canadian banks to take the lead with other governments and banks in advocating negotiations with countries experiencing difficulty in meeting the interest and debt-repayment obligations of their international debt.***
>
> ***The goal of such negotiations would be to eliminate, or reverse, the net outflow of capital from the country concerned, and to reduce the debt to a level which is humanly possible for these countries to carry, and which will leave within the countries sufficient capital to promote their own development. This should be achieved through an agreement which would normally include significant debt reduction, a rescheduling of the balance on manageable terms, and a renewed flow of development assistance and foreign investment. Canada should take the lead in the Group of Seven in advocating that the level of Third World debt be recalculated using real interest rates of 1.0 - 1.5% retroactively applied, the resulting calculation to be used as the basis for debt reduction in negotiated settlements.***
>
> ***(Recommendation #8)***

The following recommendations provide specific examples of actions which follow from this central recommendation.

Debts owed to the Export Development Corporation in sub-Saharan Africa

While we commend the Canadian government for its remission of the debts owed to the Canadian International Development Agency (CIDA) by sub-Saharan African countries, we are very concerned that debts owed to the Export Development Corporation

are still in place, and debtors are being charged significant rates of interest.[18]

Until 1988, each creditor country was obligated to give its debtor countries the same terms as were offered by the other creditors; these terms were worked out together in the Club of Paris. We welcomed the proposal made by the Canadian government and adopted by the Group of Seven Economic Summit in Toronto (1988) that individual creditor governments be allowed to offer concessionary rates on export credit debts owed by the poorest countries.

Unfortunately, since that initiative, a rise in interest rates has in effect eliminated the concessionary rate which Canada offered to African countries with outstanding loans from the Export Development Corporation.

The impact of high real interest rates has already been pointed out. It has probably been the largest single cause of the enormous growth of debt in most countries. Therefore,

> ***The churches urge the government to instruct the Export Development Corporation (EDC) to write down the debt of the sub-Saharan African countries, or at the very least reschedule it for long periods of time at minimal interest rates; other developing countries should be offered the most concessionary possible terms.***
>
> ***(Recommendation #9)***

The illegitimacy of some debts

We have recommended that the object of debt negotiation be the reduction of the debts to a level at which the net outflow of capital is stopped, and the servicing of the debt becomes "humanly possible" for the debtor country to carry. With this in mind, we would suggest several factors which we believe should be considered in the settlement of a country's debts.

In some cases, the total amount of the debt can be reduced by a mutual agreement that some portion of it is illegitimate, and should, in justice, be eliminated.[19]

Our church partners in countries where some debts were contracted by dictators for illegitimate purposes (grandiose projects, personal gain, armaments used for aggression or to repress the

opposition) have declared that they do not believe that these specific debts should be considered morally binding.

The churches recommend that negotiations with debtor countries include the elimination of some debts as being illegitimate and therefore not morally binding within the context of a negotiated settlement.

(Recommendation #10)

c) Related issues

Capital flight

The deposit overseas of the wealth of the elite in developing countries has had a serious negative impact on their debt situation. If such capital could be returned to the countries of origin, the debtor governments would be enabled to gain access to at least a portion of it for reinvestment in their economy.

We endorse the comment of the Senate Committee on Foreign Affairs in its report on the debt crisis (April 1987) that a necessary first step is for developing countries themselves to introduce measures to discourage the flight of capital, including appropriate exchange rates.[20]

However, many observers of the phenomenon of capital flight agree that money will tend to find a way around restrictions. Bankers argue that the carrot is more effective than the stick, and that the only sure way of ensuring capital's return to its country of origin is to make the climate of investment there sufficiently attractive.

Nevertheless, because of the additional problems caused by this drain of funds from desperately poor economies we believe that the countries in which flight capital is deposited should share in the task of repatriating it.

We would welcome an international agreement requiring disclosure of private and corporate bank deposits and investments of non-residents above a certain level. We realize the constraint which the principle of confidentiality of the banking system imposes on such an international agreement. Nevertheless, such confidentiality is a cloak for much illegal activity, and has resulted in considerable injustice.

The churches urge the Canadian government to study the implications of requiring the full disclosure of large- scale foreign assets held in Canada, and Canadian assets abroad, and to investigate ways and means by which flight capital could be encouraged to return to developing countries.

(Recommendation #11)

Increased investment and aid

The reluctance of First World banks and business to invest in the depressed economies of the debtor countries is both a symptom and a cause of their problems.

In order to turn around a depressed economy, an injection of new capital to provide employment and opportunities for suppliers must be found. Some of this capital could come from domestic sources. As we have noted, debtor governments would welcome the return of flight capital for reinvestment in their economies. However, for flight capital to return voluntarily, local investors must be confident that the economy is on the upswing. If debt servicing payments could be reduced, governments themselves would be able to generate significantly more domestic investment capital. In most cases, however, domestic sources could not generate enough new capital for reviving the economy and moving it to a new stage of development.

For this reason, all proposals for debt relief should be accompanied by the provision of new resources, in the form of aid, or, where it is appropriate, private investment.

Recognizing that appropriate new investment would be welcomed by most, if not all, of the debtor countries,

The churches urge the Canadian government to facilitate the investment of Canadian business in so-called "problem debtor countries", provided that its effect on the country will be positive in social as well as economic terms, that it will not hinder the ability of the government concerned to pursue independent, self-reliant development, and that its operations will be ecologically sustainable.

(Recommendation # 12)

Many debtor countries are both under-developed and lacking in resources. They are not likely to attract significant foreign investment from private sources, but must rely to a large extent on development assistance from friendly governments. In their case, not only is debt relief urgently needed, but far larger flows of aid.[21]

An additional problem facing many of these countries is that they are encouraged by the IMF to increase exports only to find their access to First World markets, including Canada's, is often rendered difficult through tariffs. International trade negotiations are frequently characterized by successful resistance on the part of the consumer nations in the northern hemisphere to efforts by the producers of the developing world to gain better terms of trade for their agricultural commodities. In addition, the prices of most Third World commodities have fallen in relative terms over the past decade. This factor in itself mitigates against many debtors' ability to improve their export earnings and thus their balance of payments.

The churches urge the government of Canada to provide increased aid to developing countries struggling with a debt burden, and increased access to Canadian markets.

(Recommendation #13)

A note on "debt-equity swaps"

Debt-equity swaps are being used extensively by the private sector as a way of converting "problem loans" into assets. There are advantages to this process, but most of them accrue to the banks, which have removed a "problem loan" from their books (albeit at a loss), and the purchaser, who is able to purchase assets in the debtor country at an extremely favourable rate of exchange. In a few cases, the governments of the country concerned have been able to buy back their loans at the discounted rate, and so retire them, but the international financial system makes this process very difficult.

It is impossible to consider these "swaps" as a "solution" to the debt crisis. For one thing, they are only relevant to countries which have marketable assets, which excludes many countries with serious debt problems.

In addition, there are a number of potential dangers in the debt-equity swap process for debtor countries. The conversion of

the loan into local currency often has an inflationary effect on the domestic economy; frequently the investment that is made is not "new" investment, but one which would have been made in any case (such as the expansion of an existing factory), but which the foreign investor is able to carry out at very advantageous terms. It is true that once the debt has been converted into equity the country no longer has to pay interest, but it has been calculated that the export of capital from the country through the return on the investment that is made may actually exceed the interest payments on the original loan.

In favour of the swaps, it is argued that the investment may produce jobs and subsidiary industries which are locally owned. Both are contributions to the country which the debt could not make.

Another danger of the debt-equity swap process is that it invites the sale of a country's assets to foreign owners. Within reason, this is acceptable, but it is theoretically possible for a small country with only a few assets and a sizeable debt to find that its debt has been converted into equity and the entire economic assets of the country have been sold. In such a case, the concept of national sovereignty has become irrelevant.

While the churches have been very skeptical of the advantages of debt-equity swaps for the debtor countries, they have given considerable attention to a related but different phenomenon sometimes known as "debt for development" swaps involving loans purchased at a discount by non-governmental organizations to use for non-profit, socially or environmentally beneficial projects in the country concerned. The organization is able to take the funds available in Canadian dollars and convert them into local currency by making use of the country's official debt-equity facility, and obtain the same very advantageous exchange rate as would be available to a commercial investor.

The advantage of participating in the debt-equity swap process is that it makes available a significantly larger sum for a project. While not all projects benefit from large sums of financing, some (housing projects and the purchase of land for conservation projects, for example) are only feasible if large sums are available.

The argument against participating in the process is that it "buys into" the status quo acceptance of the validity of the country's

debt, although in many cases the churches may believe that part of this debt had been contracted illegitimately. Moreover, participating in "debt for development" swaps accepts as valid the market's method of managing the debt crisis.

Those who argue against the churches' participation in development projects which profit from the debt discount say that such participation weakens our ability to play a prophetic role in calling attention to the suffering and injustice caused by the debt crisis.

Given the fact that there is not a clear consensus among the church development agencies on this issue:

> ***The churches recommend that all potential buyers of Third World debt, whether commercial buyers, non-profit organizations, or church development agencies, should examine proposals to exchange debt for equity on a case by case basis, assessing each carefully for its potential impact on the country concerned, and examining them in the light of the criteria outlined in section II of this paper.***
>
> ***(Recommendation #14)***

II. RECOMMENDATIONS TO CANADA'S CHARTERED BANKS

During the process of preparing this paper, representatives of the churches met with senior management of Canada's five major banks to hear their views on the Third World debt crisis, and in some cases their proposals for solutions. The following recommendations come from discussion among the churches following those meetings.

1. The role of the banks

The banks agree with the churches' recommendation on the need for more assertive government leadership. Yet one of the major stumbling blocks in the way of a resolution of this crisis is the

refusal of many of the banks to accept the reality that they cannot cover much of the principal which they have loaned, and that they will have to accept minimal rates of interest on the loans which remain current, at least until the debtors regain some measure of economic health.

The core of the problem is that this issue, which has become a crisis in political, social and human terms, continues to be regarded as a financial matter, to be dealt with by bankers and accountants who operate according to the rules of normal banking practice. These rules are no longer adequate to guide decisions which affect the lives of millions of people living on the edge of destitution. The banks are correct when they say that the governments must take the initiative, but they must themselves be prepared to have the rules of the game altered significantly in ways that will mean that the banks, and their shareholders, must accept more of the pain than they have to this point. The fact that the Canadian banks were among the nearly 500 international banks which accepted the rescheduling of Mexico's loans is an indication that they are coming to accept this reality.

However, as banks accept that losses are inevitable, we will likely see an acceleration of the trend in which banks reduce their exposure to the debtor countries by selling their loans at discounted prices. While reducing their exposure to risky loans is sound banking practice, it means that the banks are thereby lessening their involvement in the whole issue. When their exposure is reduced to a minimum, as has already happened with one Canadian bank, they can state that loans to the Third World are "discontinued business".

In the churches' view, the banks, having helped to create the problem, are now tending to back away from it, (albeit through taking a loss), and will not be part of the solution. New lending by private creditors is a vital part of the debt resolution for most of the major debtors. If the banks are no longer involved, they will not be part of helping to work out a settlement, nor will they be likely to advance new loans once such a settlement is achieved. Therefore,

> ***The churches urge the banks not to withdraw from lending to the less developed countries (LDC's), but to maintain their banking relationship with them, offering as generous and flexible terms as possible, and***

continuing to make a constructive contribution to their economies.

(Recommendation # 15)

2. Bank reserves

A major point of debate between the churches and the banks relates to the question of their reserves against possible default, and the tax treatment these reserves receive from the government. In the churches' view, this question must be considered in the context of the very large interest income the banks are receiving on their Third World loans. Despite the banks' claims that they have suffered as a result of the crisis, and have made many concessions to their debtors, their present situation is very healthy. Together, the six major banks, including the National Bank, made $2 billion profit in the first six months of their 1988-89 fiscal year, due in part to substantial interest income from Third World debtors.

The Canadian government, through the Superintendent of Financial Institutions, ruled in 1987 that the banks should substantially increase their reserves against possible default by major debtors. The government has supported the banks in making this move by providing tax deferrals, which, by a change in reserve regulations, allows the banks to declare the money placed in reserves as a normal business loss which can be claimed in the year it occurs. If a loan is later sold at a discount, the loss taken in the sale is covered by the reserves. If the loss experienced is less than the amount provided in the reserve the tax must be paid on the recovery of previously anticipated loss.

Despite the growing trend for the banks to dispose of their Third World loans, several banks continue to have large LDC loan portfolios, almost half of which are covered by money on which the tax is deferred. We recognize that tax deferral becomes tax relief only when actual losses are realized (e.g. through discounted sales) and that the tax involved will eventually have to be paid if the loans are all repaid in full. Nevertheless, the banks receive a substantial benefit through the availability of these retained funds during the period of deferral. In addition, should their losses become realized through discounted sales or other forms of write-off, the deferral becomes a realized tax benefit.

In the meantime, the debtor countries receive absolutely no benefit from this arrangement. Despite the banks' reserves, their loans remain at the same level; interest continues to be calculated and accrued on the total outstanding balance. Even if a loan is sold to a third party at a discounted value there is no benefit to the debtor country. The purchaser carries the loan at face value and continues to calculate interest on that value until such time as it may be converted into equity through a "swap". It is clear that while the government and people of Canada have provided significant accommodation to the banks to cushion their losses, no benefits have been provided to the debtor countries.

We realize that the banks have a legitimate concern to protect the rights of their stakeholders (shareholders, depositors, and employees) and the government is rightly concerned to safeguard the stability of Canada's banking system. Nevertheless, given the nature of the crisis, and the relative situations of those affected by it, the banks are in an unjustifiably favoured position. They continue to draw interest on their LDC loans, and they defer tax on very large sums of money they have set aside to cover possible defaults. While the banks are well protected, no benefit is accruing to the debtors.

Therefore, in order that no special benefits such as tax deferrals be provided to the banks for their provisions against losses on Third World debt unless the debtor country also benefits,

The churches recommend to the Canadian government that

a) tax deferrals on loan loss provisions be discontinued unless the benefits therefrom are shared in an equitable manner with the debtor countries, or

b) tax credits be provided only when debt is actually written off and deducted in the accounts of the bank.

(Recommendation #16)

CONCLUSION

The crisis caused by the debt burden of the developing world is one of the major global problems we face in the closing years of this century. It has very serious implications for the quality of life for millions of human beings, for development, the environment, and for the relationship of North and South.

The crisis evolves from week to week; during the eighteen months that have elapsed since we began work on this paper, the situation has changed significantly. There are some reasons for hope, but as yet the crushing burden of debt remains in place. The actions recommended in this paper, which seem appropriate at this point in time, may require altering or expanding as circumstances require.

Positive change occurs in developing countries - or in Canada - when people empowered by the Gospel take their economic and political futures into their own hands, and strive themselves to transform their lives. Our role is a supportive one, to reinforce their efforts by our advocacy with our own government and banks.

Economists and politicians are now vying with one another to propose ways of easing the debt burden; but democratic governments, including our own, will not adopt them unless they believe debt relief will be supported by the public. The debt issue must be raised to the level of public debate in Canada. It is the hope of the drafters of this paper that the churches will be leaders in that debate.

In its simplest form, the message is very clear. To echo President Nyerere of Tanzania, it is immoral to urge developing countries to repay their debts and leave their children starving.

ENDNOTES

1. In 1945, the financial ministers of the Allied Powers met in Bretton Woods, New Hampshire, to hammer out an institutional framework for international economic stability. Two interlocking multinational institutions were created: the International Monetary Fund (IMF) to enforce a system of stable exchange rates and provide conditional bridging finance to countries; and the World Bank to provide long-term capital loans to countries, originally to European countries for post-war reconstruction, and subsequently to Third World countries for development. These Bretton Woods negotiations continued over several years, and led to the creation of the GATT (General Agreement on Trade and Tariffs). All these institutions are still in existence.

   For more than 25 years, the Bretton Woods "system" provided a stable framework for orderly economic growth. The chief criticism laid against it was that the countries emerging from colonial status were not adequately represented. In addition, the world economic system had tripled in size since 1945, and the system was no longer adequate. Its disintegration began in 1971 when the administration of President Nixon suspended the convertability of the U.S. dollar to gold and so eliminated the standard against which all currencies were valued. Since then, currency exchanges have fluctuated against each other; far reaching financial decisions are made by the Group of Seven at the annual "Economic Summit" in which the developing world and the socialist countries are not represented.

   See *The International Financial System: An Ecumenical Critique*, World Council of Churches series *An Ecumenical Approach to Economics*, no. 4 (Geneva, World Council of Churches, 1985) pp. 20-23. This is the report of a meeting held in Geneva, November 1984 of the Advisory Group on Economic Matters of the Commission of the Churches' Participation in Development (CCPD) of the World Council of Churches, and gives a brief, clear description of the history of global finance over the past few decades.

2. Unless otherwise indicated, these comments by church partners have been paraphrased slightly from those found in *External "Dolares", Eternal "Dolores": Christian Reflections on the Debt Crisis.* Pro Mundi Vita Studies, No. 1. (Brussels, January 1988). This publication summarizes many official church statements. The exceptions are:

   The quotation in the Introduction, (p.2) from the Franciscan priest is taken from an interview quoted in *Who Owes Whom?*, Spring 1985, the newsletter of Project Abraco, Resource Centre for Nonviolence, Santa

Cruz, California. (This is a Brazilian solidarity group with strong church links.) It is included in their *Solidarity Packet on the Debt Crisis* (Santa Cruz, Project Abraco, September 1987), p. 34.

The statement (page 7) from the College of Methodist Bishops of Brazil is cited in *The Debt Crisis and the Third World*, document No. 6 of the Commission on the Churches' Participation in Development (CCPD), (Geneva, World Council of Churches, January 1986), p. 41.

The second quotation (page 7) from Cardinal Arns, is taken from a talk given by Susan George entitled "Third World Debt: the Moral and Physical Equivalent of War". The talk was given at a conference in San Francisco, October 23-24, 1987, organized by Project Abraco.

The excerpt from the Lagos *Guardian* (page 7) is reprinted in *Facts for Action*, a development education publication of Oxfam America called *Third World Debt: Payable in Hunger* #16, May 1986, p. 10.

3. For a fuller understanding of real interest rates see "To Pay is To Die", *GATT-Fly Report*, Vol. VIII, No. 4, (October 1987), pp. 2-3. For further reading, see Sue Branford and Bernardo Kucinski, *The Debt Squads: The U.S., the Banks and Latin America*, Zed Books, Ltd, London, New Jersey, 1988. See also Recommendation 8 of this paper and Endnote 16.

4. Brazilian economists have calculated their country's debt as it would be if interest rates had been constant at the 1973 level; these calculations show that Brazil paid an excess of approximately $33.8 billion between 1973 and 1985. Branford and Kucinski, p. 98. The debtor countries want interest rates to be fixed at the lowest possible level. However, the creditors resist this proposal very strongly; they maintain that the cost of borrowing money must reflect market rates, which fluctuate.

5. Report of World Council of Churches Sixth Assembly, W.C.C. 150 Route de Ferney, Geneva, Switzerland.

6. The IMF and the World Bank were designed to perform very distinct functions. The IMF's role relates largely to financial relationships between countries. Its concerns are balance of payments, exchange rates, etc. The World Bank (and the regional development banks which are also involved in setting conditions) are concerned with the internal workings of a country's economy. Unlike the IMF, the World Bank gives funds on a project basis, although in recent years it has devoted 25% of its funds to "policy objectives" - more generalized infusions of funds into a country's economy. This takes it into the wider "macro" dimensions of a country's economy away from specific projects. The World Bank now concerns itself with such things as the efficiency with which resources are being utilized, the prices being paid to producers, etc. While the IMF sets specific targets for a country - to meet a goal

for exports or to stabilize its currency - the World Bank is concerned with broader issues which can have implications for many parts of the economy.

7. "African Incomes", *Globe and Mail*, March 9, 1988, cites World Bank figures as saying that average incomes in sub-Saharan Africa declined an average of 3.7% each year from 1980 to 1985, dropped 2.7% in 1986 and 4% in 1987. This gives a total for the period of 25%.

   UNICEF, in its report, *The State of the World's Children*, Chapter Two, "Adjustment With a Human Face", says income per head fell 15% in sub-Saharan Africa from 1980 to 1985, which would yield a similar figure when the decline for 1986 and 1987 are added. This decline in average incomes continues.

   African leaders concede that part of this decline can be attributed to drought, civil war, and bad economic management, but they agree that the debt burden is the "single most crippling economic problem the continent has" (*Times* of Zambia, June 23, 1988). It now amounts to $230 billion. This figure was given in the report of the United Nations Economic Commission for Africa, *African Alternative Framework*, cited in "Helping poor seen as thrust for Africans", John Zarocostas, *Globe and Mail*, July 6, 1989.

   The summary of Chapter II of the UNICEF report cited above states (p.91):

   Malnutrition is increasing during the 1980's in many parts of the developing world. Evidence of rising malnutrition exists in ten African countries, and Belize, Bolivia, Brazil, Chile, Jamaica, Uruguay and parts of the Philippines and Sri Lanka. Infant mortality has been rising in some areas - including Barbados, Brazil, Ghana and Uruguay - after decades of decline, while the trend towards improvement has been halted in at least 21 countries... Diseases thought to have been eliminated have reappeared - yaws and yellow fever in Ghana and malaria in Peru... The health services are acutely short of drugs in most countries... In Jamaica, charges have been introduced for services which were previously free.... Education has also been affected....
   (UNICEF, The State of the World's Children, Chapter II, 1987)

8. The Standing Senate Committee on Foreign Affairs, *Canada, the International Financial Institutions and the Debt Problems of the Developing Countries* (Ottawa, April 1987), p. 68. In preparing its report the Committee interviewed both the former Finance Minister of Mexico and Barber Conable, president of the World Bank, who cited instances of difficulties caused to countries by overlapping conditions of the IMF and World Bank.

   Two further quotations illustrate the problem.

The French government resisted a plan of the African Development Bank (a regional bank, part of the World Bank) to convert African debt into long term bonds because:

it might not allow sufficient control by creditors of the economic policy of debtors to make sure that they stuck to IMF style adjustment programs. (Globe and Mail, April 21, 1988, p. 30)

Julius Nyerere, President of Tanzania, maintains that the IMF applies a double standard when it gives economic advice.

The Europeans have problems. The United States has a huge internal deficit and a huge external deficit...U.S. high interest rates are adding to the entire crisis. Does the IMF go to them and tell them what they should be doing? These institutions are becoming instruments of a new kind of empire. (Facts for Action, Oxfam America, May 1986, p. 10)

In commenting on this statement, Oxfam America notes:

In fact, the IMF has urged the United States to reduce its deficit spending, lower interest rates, etc....But since the IMF is not making loans to the U.S., it has no power to enforce its recommendations as it does in the Third World. (Facts for Action, p. 10)

In Latin America and Asia, only a few countries, such as Brazil and Mexico, are sufficiently large - and have a large enough debt - that they have some bargaining power with the IMF. Most of the smaller countries are in the same situation as those in Africa.

9. For further information see Roy Culpeper, *Beyond Baker: The Maturing Debt Crisis* (Ottawa, North-South Institute, 1987).

Another important comparison is the relationship of export earnings to the debt burden. Jamaica's case is typical of many of the smaller debtor countries. Its debt servicing (payments on principal and interest) accounts for 40% of its budget and 48% of its total earnings from exports. "Jamaica - Concessions to the poor from Seaga: Welfare handouts are from borrowed money", (*Latin American Economic Report,* London, June 30, 1988, p. 15.)

Another interesting comparison is between aid flowing from the developed world and debt service payments flowing back from the debtor countries.

Official Development Assistance from all countries to developing countries amounted to US$ 44 billion in 1986 which is about one-third the amount the Third World paid to service its US$ 1 trillion debt. (*Sharing Our Future,* CIDA, Hull, Quebec,1988 p. 20)

Other statistics confirming this fact are: the net outflow from Latin

America from 1981-87 was US$ 180 billion, (Branford and Kucinski, p. xiii); the Latin American Bureau used International Development Bank data to estimate the net transfer from Latin America at US$ 121 billion over 1982 through 1986, (*The Dance of the Millions* Jackie Roddick, Latin American Bureau, London, p. 16). Interest payments by the 15 largest Latin American debtors to commercial banks totalled more than US$ 160 billion (1983-88), ("IMF tell banks to increase efforts at solving Third World debt crisis", Jennifer Lewington, *Globe and Mail*, June 1, 1989.)

10. *Latin American Weekly Report*, 27 June, 1989, p.8.

11. This "mechanism" has been fairly widely used in some countries. A portion of the external debt of a country is purchased from the bank that holds it at a discounted price. The investor then converts it into local currency through the central bank of the country and uses it to purchase a local resource (a mine or factory, for example). From the investor's point of view, the portion of debt which has very uncertain value on the world market is thus transformed into a tangible equity. The country no longer has to pay interest on the debt, and the bank has gotten rid of a dubious asset. Although this appears to be a "win-win" solution, in fact there are many drawbacks. Please see the "A note on debt-equity swaps" in Part III.

12. Canada is a comparatively small player as a creditor in the world financial system. Nevertheless, our country has become one of the Group of Seven, the inner circle of governments of the industrialized Western World.

    There are two types of Canadian government (or "official") loans to developing countries. One is government to government loans through Canadian International Development Agency (CIDA) channels. These are for long terms and at very low rates of interest. The other is through the Export Development Corporation (EDC) to assist developing countries to purchase Canadian goods. These loans are for short terms, at commercial rates of interest.

    Since April 1986, all new bilateral Official Development Assistance (ODA) has been in the form of grants, not loans. The government has also converted the undisbursed portion of previous ODA loans to grants for all developing countries. (*Sharing Our Future*, p. 57) This means that the government is no longer in the lending business through CIDA. The EDC continues to make new loans and collect interest on existing loans.

    Canadian banks currently have about $17 billion in outstanding debts owed by "problem debtor countries". This is the term used to distinguish those countries which are having trouble maintaining their debt

payments from those (like South Korea) which have large debts but meet their interest payments promptly. Most of this bank debt is owed by countries in Latin America and the Caribbean.

EXPOSURE OF CANADIAN BANKS IN DEVELOPING COUNTRIES
(in billions)

Banks	Total Assets	Exposure to group of 32 developing countries
Royal	$114.3	$ 4.8
Commerce	98.3	1.9
Montreal	78.2	5.0
Scotia	76.1	4.1
T - D	63.1	450.0 million
National	31.5	1.4

Source: Elizabeth Moore, "Banks chalk up $2 billion profit", *Globe and Mail*, June 3, 1989, and Sandy Fife, "The Big Six count the cost of the Brady Plan", *Financial Times of Canada*, April 3, 1989.
(Note: except in a few cases, the banks do not release information regarding their loans to individual countries.)

13. These criteria are drawn from an address given by John Foster of the Division of Mission, United Church of Canada, at a consultation with representatives of Canadian banks on the international debt question. The consultation was sponsored by the Taskforce on the Churches and Corporate Responsibility, April 1987.

    The criteria are also based on principles adopted by the World Council of Churches as set out in the Prologue (pp. 1 and 2) of *The International Financial System: An Ecumenical Critique*. (Cited in Note 1)

14. The UNICEF strategy of "adjustment with a human face" aims at appropriately changing productive structures while also emphasizing:

    - more expansionary macro economics
    - concentrating sectoral policy on employment and income earning areas including small farming and informal activities
    - greater emphasis on equality as well as cost in income policies and social programs
    - compensatory programs to protect health and nutrition of the poor during restructuring, and closer monitoring of major aspects of

living standards, so as to respond more quickly to deprivation
- ecological responsibility
- democratic decision-making

It should be noted that, despite the external pressures they face, the governments of the debtor countries themselves must share part of the responsibility for not implementing more of these suggestions.

15. Independence and Internationalism. The Report of the Special Joint Parliamentary Committee on Canada's International Relations, June 1986, p. 86.

16. Real interest rates in this context are calculated using two factors.

The first is the interest rate being charged on the external debt. This is currently a fraction of a point above the base figure for international lending, which is called the LIBOR rate. LIBOR stand for the London Inter Bank Offer Rate and is the rate at which banks lend money to each other. This rate is lower than the record highs at the beginning of the decade, but not as low as it has been in the past.

The other factor in the calculation of "real interest rates" is an "index" of the commodity prices. Commodities (agricultural products and metals) exported by developing countries provide them with virtually all their export earnings and are their major source of foreign exchange. Most commodity prices have been at very low levels throughout the 1980's.

Thus, with interest rates - the rate at which the "money goes out" - remaining fairly high, and commodity prices - the rate at which the "money comes in" - remaining unusually low, the combination of the two has produced real interest rates at levels well above those of the past decade.

The significance of the issue for the Third World is reflected in a statement issued by a conference held by 26 national trade union centres in Africa in Addis Ababa in December 1987.

Having expressed their "grave concern" at the staggering amount of Africa's external debt, which has reached the $228 billion dollar mark in 1987, and which continues to grow at a rapid rate, they went on to say that they felt equally concerned over the amount spent on interest, which in 1987 was $27 billion for Africa as a whole. The African continent simply cannot carry this amount of "debt servicing", which from the perspective of development is completely non-productive. In fact, as their statement says, this problem has retarded the continent's progress on all fronts. (from a report of the conference in the World

Trade Union Movement, No. 7, 1988)

Source for the following table: *World Bank, Developing Country Debt: Implementing the Consensus*, abridged version of *World Bank Tables* 1986-87 edition, p. xii. It illustrates how interest rates for developing countries have remained at unusually high levels.

Real Interest Rates & LIBOR 1975 - 1986

	1975	1976	1977	1978	1979	1980
Six months LIBOR average	7.7	6.3	6.6	9.5	12.1	14.3
Real interest rates for developing countries	12.0	-1.9	-3.3	5.3	-9.7	-7.4
	1981	1982	1983	1984	1985	1986
Six months LIBOR average	16.6	13.3	9.9	11.2	8.6	6.8
Real interest rates for developing countries	16.1	21.4	12.6	12.4	11.8	13.4

From what we know of interest rates and commodity prices, it is safe to assume that the real interest rates for developing countries have remained at a very high level.

17. The UNICEF report, *The State of the World's Children*, 1987, details the need for such "quality of life" indices.

The summary of Chapter II, p. 99 states:

It is essential to monitor systematically what is happening to human beings, and essentially the poor, during (structural) adjustment. This is far more important than the readily available economic statistics which are generally used to monitor adjustment programs. Yet few countries monitor the human dimension, and data are usually inadequate. Nutrition surveys are rare. Information on the earnings and expenditures of low income households is uncommon. Even when information exists, there are frequently delays in publishing it.

18. Loans from the Export Development Corporation to sub-Saharan

African countries are held by: Benin, Botswana, Cameroun, Congo, Gabon, Ghana, Ivory Coast, Kenya, Madagascar, Liberia, Senegal, Sudan, Swaziland, Tanzania, Zaire, Zambia, Zimbabwe.

19. It is important to realize that our church partners are *not* supporting the total repudiation of all debts. Moreover, any kind of *repudiation* should be distinguished from a *moratorium* which is a temporary suspension of payment. Our partners' intent and the intent of Recommendation 10 is to advocate the *selective repudiation of some debts in the context of a negotiation.*

According to the Philippines "Freedom from Debt" coalition, a partner group of GATT-Fly, church and popular groups in both the Philippines and Brazil are working on criteria to identify loans which might be repudiated.

In the Philippines, the following criteria are being considered:

1. loans stolen by corrupt members of a former dictatorship (deposited overseas or diverted to personal use);
2. loans spent on over-priced equipment (as part of a "kick- back" scheme with foreign businesses by which local government leaders and officials profited);
3. loans for "white elephant" projects;
4. loans used for purchase of arms with which to repress the population.

Legal mechanisms are being sought to declare debts incurred by dictatorships for these purposes as not legally binding by international law (*IBON Facts and Figures* No. 188, June 1986.)

In Brazil, the conference of Brazilian bishops has called for a public audit of Brazil's external debts to determine responsibility for their origin, their use and their legitimacy. They are considering criteria which would be similar to those of the group in the Philippines. This information is contained in a statement issued by the Assembly of the Conference of Bishops, April 13-22, 1988. (*Informativo da Divida Externa*, No. 15, May 1988, p. 7.)

Studies have been conducted of historical precedents for invalidating or writing off loans made to countries. See Gonzalo Biggs, *A Crise da Divida Latino-Americano e alguns precedentes historicos*, Pay E Terra, Rio de Janeiro, 1987.
It is also important to note a distinction in terminology made by some church partners. A statement issued several years ago by Roman Catholic bishops in the U.S. called for "debt forgiveness". The response of their brother bishops in the Philippines included the comment that they objected to the use of the term "forgiveness" because it implied that the responsibility rests only with the debtor. They do not want

their country *forgiven* for debts which were illegal from the start - they want these particular debts *cancelled.* It is a question of justice, not philanthropy.

20. Senate Standing Committee on Foreign Affairs, *Report*, p. 54.

IMF sources give a figure of $150-200 billion for capital which left the developing world for private bank accounts in Switzerland and the U.S. from 1974-1985. $30 billion of this is from Africa.

21. The Parliamentarians for World Order from the Group of Ten (Group of seven plus Spain, the Netherlands and Australia) held a conference in Amsterdam in March-April 1989 on "Third World Debt and Financial Reform". The following are extracts from the recommendations contained in their report:

The Toronto Summit set an important precedent by authorizing debt reduction in connection with rescheduling in the Paris Club. Africa and other low income countries' need for external resource flows and debt reduction have not yet however been adequately addressed. For most of these countries, recovery has yet to begin.

For these countries, we therefore recommend:

- a write-down of a significant portion of Paris Club debt
- a moratorium of ten years on all official (owed to governments) interest and principal payment obligations
- the use of IDA (most concessionary) terms on these re- scheduled payments
- that the budgetary costs of these debt reductions be added to aid donor components and not be taken from existing aid allocations
- that aid donors who have not yet done so plan now a program of cancellation of their aid related debts
- significant expansion of concessional resource flows
- the development of improved means of encouraging the restoration of eligibility for such countries in arrears to the IMF

Amsterdam Appeal: Report of the Conference on Third World Debt and Financial Reform, March 30-April 1, 1989.